

INTOSAI



*Practice Note to ISA 705*

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*Modifications to the Opinion in the  
Independent Auditor's Report*

# INTOSAI



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*This Practice Note in combination with the International Standard on Auditing (ISA) 705 "Modifications to the Opinion in the Independent Auditor's Report" issued by the International Federation of Accountants (IFAC) constitute ISSAI 1705.*

*Practice Note to International Standard on Auditing (ISA) 705(Revised)*

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# Modifications to the Opinion in the Independent Auditor's Report

## Background

This Practice Note provides supplementary guidance on ISA 705 (Revised) – Modifications to the Opinion in the Independent Auditor's Report. It is read together with the ISA. ISA 705 (Revised) is effective for audits of financial statements for periods ending on or after December 15, 2016. The Practice Note is effective the same date as the ISA.

## Introduction to the ISA

ISA 705 (Revised) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with ISA 700 (Revised)<sup>1</sup>, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

## Types of Modified Opinions

ISA 705 (Revised) establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

## Content of the Practice Note

- P1. The Practice Note provides additional guidance for public sector auditors related to:
- (a) Overall considerations.
  - (b) Circumstances when a modification to the auditor's opinion is required.
  - (c) Determining the type of modifications to the auditor's opinion.
  - (d) Nature of material misstatements.
  - (e) Nature of an inability to obtain sufficient appropriate audit evidence.
  - (f) Form and content of the auditor's report when the opinion is modified.
  - (g) Communication with those charged with governance.

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<sup>1</sup> ISA 700, "Forming an Opinion and Reporting on Financial Statements."

## Applicability of the ISA in Public Sector Auditing

- P2. ISA 705 (Revised) is applicable to auditors of public sector entities in their role as auditors of financial statements.

## Additional Guidance on Public Sector Issues

- P3. ISA 705 (Revised) contains application and other explanatory material with considerations specific to public sector entities in paragraph A14 of the ISA.

## Overall Considerations

- P4. The objectives of a financial audit in the public sector are often broader than expressing an opinion whether the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework (i.e. the scope of the ISAs). The audit mandate, or obligations for public sector entities, arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives, which may be of equal importance to the opinion on the financial statements, may include audit and reporting responsibilities, for example, relating to reporting whether public sector auditors found any instances of non-compliance with authorities including budgets and accountability frameworks, and/or reporting on the effectiveness of internal control. However, even where there are no such additional objectives, there may be general public expectations in regard to public sector auditors' reporting of non-compliance with authorities or reporting on effectiveness of internal control. Public sector auditors with responsibilities concerning non-compliance with authorities consider the INTOSAI Compliance Audit Guidelines (ISSAI 4000<sup>2</sup> and 4200<sup>3</sup>).
- P5. When considering the table in paragraph A1 of the ISA, public sector auditors having reporting responsibilities related to non-compliance with authorities may need to apply the guidance within the ISSAI 4200<sup>4</sup>. It provides guidance regarding the auditor's judgment about how the nature of matters giving rise to a modification, and the pervasiveness of their effects or possible effects, influence the type of opinion on non-compliance with authorities to be expressed. Public sector auditors may apply ISAE 3000<sup>4</sup> as well as ISSAI 4100<sup>5</sup> for other assurance engagements.

## Circumstances When a Modification to the Auditor's Opinion is Required

- P6. In addition to the requirements in paragraph 6 of the ISA, public sector auditors having responsibilities relating to non-compliance with authorities or internal control, while conducting the audit of financial statements, consider that a modified opinion on these elements does not in itself lead to a modified opinion on the financial statements. Public sector auditors consider whether the matter related to non-compliance is:

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2 ISSAI 4000, "General Introduction to Guidelines on Compliance Audit."

3 ISSAI 4200, "Compliance Audit Guidelines Related to Audit of Financial Statements."

4 ISAE 3000, "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information."

5 ISSAI 4100, "Compliance Audit Guidelines for Audits Performed Separately from the Audit of Financial Statements."

- (a) Appropriately disclosed in the financial statements as required by the applicable financial reporting framework;
- (b) Properly accounted for in the financial statements as regards the financial consequences of that non-compliance; and
- (c) Material or pervasive and therefore requires a modified opinion on the financial statements.

## Determining the Type of Modification to the Auditor's Opinion

- P7. In addition to the responses required by paragraph 13(b) of the ISA, public sector auditors may be required to, or decide to, report to the legislature or other regulatory bodies as appropriate about any instances of management refusing to remove restrictions on access to audit evidence.

## Nature of Material Misstatements

- P8. When applying paragraph A3 of the ISA public sector auditors will also find further guidance in ISSAI 1450<sup>6</sup> paragraph 14.

## Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence

- P9. Additional examples of circumstances beyond the control of the entity as described in paragraph A10 of the ISA may, in the public sector, include limitations imposed by:
- Those charged with governance or other parts of the legislature.
  - Regulations on classification of information due to national security and proprietary information.
- P10. Additional examples of circumstances relating to the nature or timing of the auditor's work as described in paragraph A11 of the ISA may, in the public sector, include legislative changes, national disasters and political decisions such as military operations and major relocation of government operations.

## Form and Content of the Auditor's Report When the Opinion Is Modified

- P11. In the public sector it may not always be relevant to quantify the effect on income tax, income before taxes, net income and equity, as suggested in paragraph A22 of the ISA. Public sector auditors may instead quantify the effects on the financial statements in other terms such as gross expenditures, gross revenue or national debt or surplus.
- P12. The illustrations provided in the appendix of the ISA and in ISSAI 4200<sup>7</sup> appendices 8, 9 and 10 may be useful to public sector auditors in developing a modified auditor's opinion.

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<sup>6</sup> ISSAI 1450, "Evaluation of Misstatements Identified during the Audit."

<sup>7</sup> ISSAI 4200, "Compliance Audit Guidelines Related to Audit of Financial Statements."

## Communication with Those Charged with Governance

- P13. Public sector auditors may be required to, or may decide to, communicate with other intended users, such as the legislature, in addition to those charged with governance, as set out in paragraph 30 of the ISA.